WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

VIA email at regs.comments@federalreserve.gov

June 21, 2011

Ms. Jennifer J. Johnson
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington, D.C. 20551

Re: **Credit risk Retention Docket R-1411**

Dear Ms. Johnson:

I am contacting you on behalf of Woodstock Institute regarding the interagency credit risk retention proposal to define a Qualified Residential Mortgage (QRM) as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Specifically, we are responding to the agencies' request for comment on the proposed amount of a borrower's down payment[1] and the agencies' proposed ability to repay requirements.[1] Woodstock Institute encourages the agencies to significantly modify the current proposed rule in order to preserve homeownership as a housing option for low-wealth Americans who are creditworthy but lack savings for large down payments.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. We conduct research on financial products and practices, promote effective state and federal policies, convene a coalition of community investment stakeholders working to improve access to credit, and help people use our work to understand the issues and develop and implement solutions.

About the Interagency Risk Retention Proposal

When Congress was drafting the Dodd-Frank Wall Street Reform and Consumer Protection Act, policymakers were rightly concerned that risky subprime and non-traditional loans were issued in large volumes because institutions did not experience direct financial consequences for high default rates. Woodstock Institute's research on the housing market in the Chicago region has illustrated the consequences of this practice. High-cost subprime lending was shown to be a primary driver of concentrated neighborhood foreclosures, which in turn significantly depressed the values of nearby property values.

Woodstock Institute shared policymakers' concerns and encouraged them to take steps to restrict the availability of high-cost mortgages with potentially abusive features, particularly in cases where borrowers would likely qualify for 30-year, fixed rate, prime mortgages. Rather than prohibit non-traditional loans outright, Woodstock Institute supported the decision imposed a 5 percent risk retention requirement for subprime and non-traditional loans to provide mortgage originators with a strong incentive to conduct proper underwriting and income documentation. We consider risk retention to be a compromise between an outright ban on subprime lending and a continuation of the careless underwriting standards and proliferation of reckless products that brought about the current crisis.

We continue to support the Dodd-Frank Act risk retention requirements for non-traditional products, however, we do not believe that risk retention requirements are necessary for all mortgage products. In response to the risk retention requirement established by the Dodd-Frank Act, regulators moved to establish a broad definition of a "qualified residential mortgage," or a mortgage that would be expect from the risk retention provisions.

Of particular concern, and what we will address in the these comments, are the proposed requirements that QRM loans have a 20 percent down payment, payment-to-income ratios of 28 and debt-to-income ratios of 36 percent. Careful consideration will show that properly underwritten, low-down payment, 30-year, fixed rate, prime mortgages have been, and will continue to be, the least risky, most appropriate, and most accessible mortgage product for the vast majority of borrowers. We hope that the interagency revised rule is modified to ensure that these loans continue to be available, particularly in the case of qualified low-wealth borrowers and borrowers living in communities of color.

Our recommendations on how the proposed QRM definition should be changed focus on two particular underwriting criteria: down payment requirements and ability to repay requirements (payment-to-income ratios and debt-to-income rations).

Low down payments did not cause the ongoing foreclosure and economic crisis

According to FDIC Chairman Sheila Bair, more than half of subprime loans securitized during 2006 and 2007 ended up in default.[1] Problematic adjustable rate mortgages with payment options poorly explained to borrowers also ended up with high default rates impacting middle-income communities. It was the risky and abusive features of subprime, adjustable rate, and other nontraditional loans that drove the crisis, not low down payments.

In contrast to the high default rates associated with subprime and non-traditional loans, the regulators' analyses show that traditional 30-year fixed rate mortgages, even those with low down payments (less than 20 percent) have default rates 1 to 2 percentage points higher than loans that qualify for QRMs and have 20 percent down. While default rates are modestly higher, low down payments were clearly not the cause of the ongoing foreclosure and economic crisis.

[1]Bair, Sheila. "Chairman Bair's Statement on Credit Risk Retention Notice of Proposed Rulemaking." 29 Mar 2011. Web. 1 June 2011.

Proposed PTI and DTI ratios will reduce the number of loans that qualify as a QRM with little effect on default rates

An equaling troubling aspect of the QRM proposal is the ratios regarding housing payment-to-income (PTI) and debt-to-income (DTI). The agencies propose that loans would qualify for QRMs only if their PTI and DTI ratios are 28 and 36 percent, respectively. The FHFA's data analysis shows that PTI and DTI limits disqualify more loans from QRM status than even the low down payment requirement.[2] While high PTI and DTI ratios have been shown to have limited, negative on loan performance, research conducted by the Federal Housing Finance Agency indicates that other factors, such as low credit score, had a greater effect on delinquencies than relaxing PTI and DTI ratios. There is also evidence that, along with responsible underwriting criteria and income documentation, that low default rates could be achieved with DTI ratios exceeding the proposed rules. Loans backed by the Federal Housing Administration (FHA) exhibit considerably lower default rates than subprime loans, and FHA loans have DTI ratio limits as high as 41 percent.[3]

The current proposal will lock low-wealth people and others out of homeownership all together

Low-wealth Americans, first-time homebuyers, or current homeowners that lack significant equity in their home due to declining home values will have considerable difficulty providing 20 percent down payments even for homes that are modestly priced. In Illinois, people of color are far less likely than white people to possess assets, such as savings, that could be used to meet this new down payment requirement. While 19 percent of white families in Illinois are considered asset poor, 48 percent of Latino families and 51 percent of African American families are asset poor.[4] Prime conventional lending has plummeted for all borrowers but particularly for minorities during the last several years. In the Chicago region, conventional prime lending (home purchase and refinance loans combined) declined dramatically, but the decline in lending was much more pronounced in communities of color than in predominantly white communities. Between 2006 and 2008, communities of color saw a 53.7 percent decline, compared to a 20.3 percent decline in predominantly white communities. Restrictive QRM standards will unnecessarily reduce lending in these communities even further.

Proposed QRM definition should follow FHA guidelines

The regulatory agencies assert that many mortgages will continue to be made that are not QRMs. They state that institutions will either hold these loans in portfolio or retain 5 percent of the risk when they sell the loans. However, QRMs could very well set the standard for the entire market meaning non-QRM loans will either not be available or will be much more costly. In real terms, this could mean significantly less credit or much more expensive credit for many Americans. We therefore urge the agencies to allow down payments of 3 to 5 percent and DTI ratios consistent with FHA guidelines to qualify as QRM.

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[2] Lawler, Patrick. *Understanding the Implications and Consequences of the Proposed Rule on Risk Retention*. Federal Housing Finance Agency, 2011. Web.

[3] " Total Fixed Payments to Effective Income Ratio" Federal Housing Administration Handbook 4511.1 4.F.2.c

[4] Thomas, Ebony, and Giangreco, Chris. *Disparities in Asset and Ownership: Limitations to the American Dream in Communities of Color*. 2011. Web.

The Dodd-Frank Act does not explicitly state that the agencies include a 20 percent down payment requirement in the QRM guidelines. We believe that it was not the intent of Congress to so narrowly proscribe underwriting criteria that has been shown to fall short of achieving the desired effect of significantly lowering default rates. Rather than unfairly and unnecessarily lock millions of qualified low-wealth borrowers and borrowers of color out of affordable, sustainable credit opportunities, we encourage the agencies to modify the proposed rules to define a QRM according to FHA underwriting guidelines.

Woodstock Institute appreciates the opportunity to comment on this important issue and look forward your response.

Sincerely,

Tom Feltner
Vice President

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